NO. 10,356

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

GUARANTY TRUST COMPANY, a corporation, as liquidating trustee of Yakima Holding Corporation,
Appellant

v.

UNITED STATES OF AMERICA,
Apellee

And

UNITED STATES OF AMERICA,
Appellant

v.

GUARANTY TRUST COMPANY, a corporation, as liquidating trustee of Yakima Holding Corporation,
Apellee

On Appeals from the District Court of the United States for the Eastern District of Washington

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the District Court (R. 465-480) is reported in 44 F. Supp. 417.

JURISDICTION

These cases[1] represent an appeal taken by the Guaranty Trust Company, as liquidating trustee of the

[1]A stipulation entered into between the parties hereto, filed with and approved by this Court, provides that both appeals herein may be consolidated for purposes of briefing, argument, hearing and decision, as the taxpayer states. (Br. 23.)

Yakima Holding Corporation, and a cross-appeal by the United States from the judgment entered July 31, 1942, by the District Court in favor of the Trust Company in the sum of $12,793.04, with interest according to law and costs (R. 498-499), in an action, tried without a jury (R. 480), filed by the Trust Company to recover corporate income and excess profits taxes, penalties and interest paid by the taxpayer in the aggregate sum of $26,933.86 for the calendar year 1935 (R. 3-15). The action arose and jurisdiction in the District Court was vested under Section 24, Twentieth, of the Judicial Code, as amended, and Section 3772 of the Internal Revenue Code. (R. 3.) The cases are brought to this Court by notices of appeal filed by the United States (R. 505) and by the Guaranty Trust Company (R. 499-500) on October 27 and 28, 1942, respectively. The jurisdiction of this Court is invoked by virtue of the provisions of Section 218(a) of the Judicial Code, as amended.

QUESTION PRESENTED[2]

Whether the entire profit realized from the sale in the taxable year 1935 of 11,000 shares of Sunshine Mining Company stock was properly chargeable and taxable to the Yakima Holding Corporation in that year, as contended by the Government, or to the Yakima First National Bank, its wholly owned subsidiary, as contended by the Guaranty Trust Company.

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[2]Another question—involving the imposition of fraud penalties upon the taxpayer, under Section 293(b) of the Revenue Act of 1934 (R. 11, 20, 22)—was decided favorably to the Guaranty Trust Company (R. 464-465, 479-480, 495-496) but was not appealed by the Government.

STATUTE AND OTHER AUTHORITIES INVOLVED

The pertinent statute and other authorities are set forth in the Appendix, *infra.*

STATEMENT

The pertinent facts were found by the District Court substantially as follows (R. 481-492, 494-496):

At all times herein mentioned the Guaranty Trust Company (hereafter called the Trust Company) was and now is a corporation duly organized and existing under and by virtue of the laws of the State of Washington, and engaged in transacting and duly authorized and qualified to transact a trust company business. Its principal place of business is situated in the city of Yakima, Yakima County, Washington (R. 481.)

At all times from 1930 until 1937, the Yakima Holding Corporation (hereafter called the Holding Company) was a corporation duly organized and existing under and by virtue of the laws of the State of Washington, with its principal place of business at Yakima, Yakima County, Washington. The Holding Company was duly disincorporated and dissolved during the year 1937 pursuant to the laws and statutes of the State of Washington. Prior to its dissolution and on or about November 10, 1936, all of the assets, funds and property of every kind and character whatsoever of the Holding Company were duly transferred, assigned and conveyed to the Guaranty Trust Company as liquidating trustee, and at all times there-

after the latter company has been and now is the duly appointed, qualified and acting liquidating trustee of the Holding Company. (R. 482.)

During 1935 and for a number of years both prior and subsequent thereto, the Yakima First National Bank (hereafter called the Bank) was a duly organized and existing national banking association engaged in transacting business at Yakima, Yakima County, Washington, as a national bank. During the years 1934 and 1935, the Holding Company was a holding corporation owning practically all of the stock of each the Bank, the First National Bank of Wapato, a national banking association located at Wapato, Yakima County, Washington, and the Guaranty Trust Company, except directors' qualifying shares in each of these banks and the Trust Company. (R. 482-483.)

The officers of all four corporations were practically identical and the majority of the directors and members of the executive committees thereof were identical. All of the corporations were dominated by R. M. Hardy and a small group of associates. R. M. Hardy was president of each of the corporations and was also president of Sunshine Mining Company (hereafter referred to as Sunshine), a prosperous mining corporation. During the time herein involved, the Bank had not recovered from the losses sustained during the depression of the preceding years, and by reason thereof the capital of the Bank was impaired and there was insistence by the National Banking Department that the Bank strengthen its financial position. During the time immediately preceding the

transactions involved herein, there occurred a phenomenal activity in the stock of Sunshine which pointed to the situation which later developed of a very rapid substantial appreciation of the market value of Sunshine stock. (R. 483.)

In August, 1934 the Holding Company, which was then indebted to the Bank in the sum of $60,000, and which at that time received $75,000 in cash from R. M. Hardy, purchased 7,500 shares of Sunshine stock, of which 5,000 shares were taken in the name of the Bank and 2,500 shares were taken in the name of George Bradshaw, who was the secretary of the Holding Company and also a director and member of the executive committee of the Bank, as a street name. The Holding Company paid the purchase price or cost of the 7,500 shares of Sunshine stock in the sum of $59,576.50. On December 12, 1934, an agreement was entered into between the Holding Company and the Bank, executed in the form of an accepted letter, as follows (R. 484-486):

Yakima Holding Corporation
Yakima, Washington
December 12, 1934

Yakima First National Bank
Yakima, Washington
Gentlemen:

In order to confirm an understanding we have had with the bank regarding the purchase of 7500 shares of Sunshine Mining Company stock, I thought it advisable to write this letter. It was understood that this stock was to be purchased by the Yakima Holding Corporation and held by

it for the account of the bank. The Yakima Holding Corporation was to be reimbursed for the amount actually paid for the stock, plus a small appreciation to be determined at the end of the year if this should be deemed necessary. We, therefore, treated this stock as being held for the bank, and if any loss results it is to be the loss of the bank and, of course, in any profit results it will likewise accrue to the bank.

I am taking this opportunity also of setting out the understanding reached in connection with the proposal submitted by us to Mr. Alexander Miller to exchange 4000 shares of stock of the Yakima Holding Corporation for 5000 shares of stock of the Sunshine Mining Company. We are doing this on the express understanding that stock of the Sunshine Mining Company will be taken over by the bank at the stipulated price of $12.00 per share. This understanding is to apply to any further similar transactions.

I would ask you to signify that this is also in accordance with your understanding of these transactions by signing the acknowledgment on the bottom of this letter.

Yours very truly,

GEO. H. BRAWSHAW,

Secretary.

The above represents the understanding that has been reached between the bank and the Yakima Holding Corporation with respect to the matters set out above and the same is hereby approved.

YAKIMA FIRST NATIONAL BANK,

By H. F. CRAWFORD,

Cashier.

On January 6, 1935, an entry was made in the books of the Holding Company showing the "appreciation write-up" as to the 7,500 shares at the rate of 25 cents per share in the sum of $1,875, in accordance with the above agrement; and the latter amount was reported as income of the Holding Company in its income tax return for 1935 as profit on the sale of stock. The Holding Company received and retained the dividends paid upon the Sunshine stock herein referred to until it was delivered to the Bank and sold by the Bank in April, 1935; and the Holding Company reported the dividends in its income tax return, as its income, in accordance with the verbal understanding between the Bank and the Holding Company. (R. 486.)

On February 5, 1935, at the annual stockholders' meeting of the Holding Company, the financial statement of the Holding Company was presented which, among other things, in the list of assets provided as follows: "Other stock investments, $61,451.50," which included and referred to the investment in the above-mentioned 7,500 shares of Sunshine stock. No reference was made in the minutes of the stockholders' meeting to the stock being held by the Holding Company in trust or as trustee for the Bank, or that such stock had been sold to the Bank. (R. 486-487.)

On April 12, 1935, a meeting of the executive committee of the Holding Company was held, and the minutes of the meeting provide in part as follows (R. 487-488):

Mr. Hardy stated there were several matters that required action by the executive committee and stated that the first matter was a proposal to Mr. Alex Miller to exchange 4000 shares of stock of the Yakima Holding Corporation for 5000 shares of Sunshine Mining Company stock on the basis of placing a value of $15.00 per share on the stock of the Holding Corporation and $12 per share on the stock of the Sunshine Mining Company. This proposal was made to Mr. Miller under date of December 11, 1934, and accepted by him. It was then moved by Mr. Clift, seconded by Mr. Rightmire, that we approve and ratify the proposal for the exchange of stock as outlined and authorize its completion. Carried.

The secretary then stated that at the time this transaction with Mr. Miller was discussed by the officers an understanding was reached that if the transaction were completed that the Yakima First National Bank would take over from the Yakima Holding Corporation the 5000 shares of Sunshine at $15.00 per share; also the 7500 shares of Sunshine stock already owned by the Yakima Holding Corporation at the cost price of same, all in accordance with a letter setting out this understanding dated December 12, 1934, from the secretary to the bank and approved by the bank.

It was then moved by Mr. Rightmire, seconded by Mr. Clift, that the arrangements between the Holding Corporation and the bank as outlined by the secretary be approved and ratified, which motion being put was unanimoustly approved.

The use of the figure $15 per share in reference to the 5,000 shares of Sunshine stock in the minutes of the Holding Company executive committee for the

meeting of April 12, 1935, was based upon inadvertent error and mistake, and the correct amount thereof was in truth and in fact $12 per share, and the Miller transaction was carried out upon the basis of $12 per share paid to Miller for the 5,000 shares of Sunshine stock, rather than $15 per share. (R. 488.)

At the time of the purchase of the 7,500 shares of stock, entries were made with reference thereto on the books of the Holding Company in its ledger account and its cash disbursement journal, entitled "Sunshine Mining Co. stock." The ledger entries with reference thereto have as specifically designated items on the ledger page the initials Y F N B for the description of the number of shares and the price paid for each share. Other sheets of the ledger show that almost without exception similar designations were placed in front of the descriptions of property, the title of which was concededly in the Holding Company. (R. 488-489.)

In April, 1935, the 7,500-share block of Sunshine stock was sold by the Bank for $135,835.54. The cost of such stock to the Holding Company was $59,576.50, making a gross profit on the purchase and sale, if the stock and the profit thereon belonged to the Holding Company, of $76,259.04. The cost of such stock to the Bank was $61,451.50 (being the amount the Bank agreed to pay the Holding Company and the amount of interest therein reported by the Holding Company to its stockholders), making the gross profit on the purchase and sale, if the stock

belonged to the Bank in 1935, $74,384.04. The court found that such profit constituted income of the Holding Company for the year 1935 and not income of the Bank. (R. 489.)

On December 11, 1934, the Holding Company wrote to Alex Miller offering to exchange 4,000 shares of stock in the Holding Company, on the basis of $15 per share, for 5,000 shares of Sunshine stock on the basis of $12 per share. By letter of December 11, 1934, Miller accepted this offer and on the same date he deposited with the Trust Company his certificate for 5,000 shares of the Sunshine stock, authorizing the Trust Company to deliver it to the Holding Company in exchange for 4,000 shares of stock in the Holding Company. Mr. Miller's letter imposed a condition of the exchange, but the court below found that such condition and proviso were waived by Mr. Miller and that he consented that the exchange deal be consummated without compliance with any condition. (R. 489-490.)

On December 12, 1934, the Holding Company by its secretary, George H. Bradshaw, wrote the above-quoted letter of that date to the Bank. The foregoing agreement was executed and delivered on December 12, 1934, and was performed. (R. 490.)

No entries were made in the books of the Holding Company with reference to the Alex Miller transaction or the 5,000 shares of Sunshine stock, and the stock never stood in the name of the Holding Company. (R. 490.)

In April, 1935, the 7,500 shares and 5,000 shares of Sunshine stock hereinabove referred to, or a total of 12,500 shares which had been theretofore delivered to the Bank, were delivered by the Bank to Drumheller, Ehrlichman & White, a stock brokerage concern, who sold 11,000 shares thereof on the instruction of the Bank. The brokers paid to the Bank therefor $135,835.54 as the net proceeds of sale of the 7,500 shares of Sunshine stock, and $63,389.91 as the net proceeds of sale of the 3,500 shares of Sunshine stock which constituted a part of the block of 5,000 shares acquired from Alex Miller, or a total selling price of the 11,000 shares in the sum of $199,-225.45. The remaining 1,500 shares of the Sunshine stock were duly redelivered to the Bank by the brokers. (R. 490-491.)

Out of the proceeds of the sale the Bank paid Miller for the 5,000 shares of Sunshine and paid the Holding Company the amount which it had paid for the 7,500 shares, its costs incurred, and the 25 cents per share appreciation, all in accordance with the agreement of December 12, 1934. (R. 491.)

The selling price of the 3,500 shares, or the net proceeds of the sale thereof, was $63,389.91, and the cost or purchase price thereof was $42,000. The resulting profit on the purchase and sale of the 3,500 shares of Sunshine stock was $21,389.91. The income or profit on all of the stock, both the blocks of 7,500 and 3,500 shares, was actually received and retained by the Bank. (R. 491.)

The transaction with Alex Miller with reference

to the 5,000 shares of Sunshine stock was originally in December, 1934, and at all times made, agreed upon, consummated and put through for the benefit of the Bank. The reason for the method used in handling the transactions was that the parties realized the restrictions upon national banks in the purchase of stock in mining corporations. The transactions were not handled in that manner in order to evade or reduce payment of income taxes of either the Bank or the Holding Company. (R. 492.)

The transaction as to the 7,500 shares of Sunshine stock and the Alex Miller transaction as to the other 5,000 shares of Sunshine stock were at all times two separate and distinct transactions. The 5,000 shares of Alex Miller Sunshine stock were never in the possession of the Holding Company. (R. 492.)

The court found that the 5,000 shares of Sunshine stock were acquired from Alex Miller for the Bank, and the Holding Company acted in a trust capacity for, or as the agent of, the Bank and that at all times, until the sale thereof, the actual, equitable and beneficial owner and holder of the 5,000 shares of Sunshine stock was the Yakima First National Bank and was not the Holding Company. (R. 492.)

Thereafter, in 1937, the United States Commissioner of Internal Revenue assessed a deficiency against the Trust Company for income tax [on the Holding Company's income (R. 445)] for the year 1935 in the sum of $13,037.55, together with a 50%

fraud penalty thereon, under Section 293(b) of the Revenue Act of 1934, in the sum of $6,518.78[3], and a deficiency in excess profits tax agains the Trust Company for the year 1935 in the sum of $3,477.96, and a 50% fraud penalty thereon in the sum of $1,738.98, or total additional tax in the sum of $16,-515.51, plus 50% fraud penalty thereon in the sum of $8,257.76, or the total sum of $24,773.27. (R. 494.)

Thereafter, in May, 1937, the Trust Company duly mailed and filed with the Commissioner of Internal Revenue, as provided by law, a written, sworn protest as to deficiency tax assessments and penalties, and sworn affidavits in support of the protest. The protest was overruled and denied by the Coommissioner and the alleged tax deficiency assessments and penalties were ordered paid. On or about May 27, 1938, the Trust Company paid to the United States the sum of $24,773.27, plus interest thereon in the sum of $2,160.59 to such date, or a total payment of $26,933.86, in payment of the alleged deficiency tax assessment and penalties as required by the Commissioner. (R. 494-495.)

Thereafter, on or about March 1, 1940, the Trust Company duly filed with the United States separate written, sworn claims for refund of the alleged additional taxes and penalties assessed against it. On or about October 4, 1940, the United States, through the Commissioner, disallowed and denied the claims for refund. (R. 495.)

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[3]Any further facts relative to the penalties are included for purposes of clarity. See footnote 1.

The Collector of Internal Revenue by whom the income and excess profits taxes and penalties were collected from the Trust Company is not now in office as Collector of Internal Revenue and was not in office as such at the time of the commencement of this suit. The present United States Collector of Internal Revenue for the State of Washington took office as such only a few months prior to the commencement of this action. (R. 495.)

Upon the basis of the foregoing facts, the District Court held that the profit realized on the sale of the 7,500 shares of Sunshine stock was chargeable to the Holding Company and that the profit on the 3,500 like shares was chargeable to the Bank. (R. 465-480.) The court thereupon entered judgment accordingly (R. 498-499), from which both parties appealed (R. 499, 505).

STATEMENT OF POINTS TO BE URGED BY THE UNITED STATES

The District Court erred (R. 505-506, 518):

1. In holding that the Yakima First National Bank was the equitable owner of 3,500 shares of stock of the Sunshine Mining Company.

2. In not holding that the Bank was not entitled to purchase the Sunshine Company's shares for its own account.

3. In not holding that the Bank had no capacity to take legal title to the shares and, therefore, it

could not become the beneficiary of a trust for such property.

4. In holding that the Yakima Holding Corporation acted in a trust capacity for or as agent of the Bank, and that at all times until the sale thereof the actual, equitable and beneficial owner and holder of the 3,500 shares of Sunshine stock was the Yakima First National Bank, and not the Holding Company.

5. In entering judgment for the Guaranty Trust Company.

SUMMARY OF ARGUMENT

1. With respect to the 7,500 shares, the District Court was clearly correct in its decision that the taxpayer had failed to sustain its burden of establishing the existence of a trust. The actual handling of the matter by the parties was quite inconsistent with the contention that a trust existed. The evidence as to the existence of the trust is not persuasive, and the purchase of the stock by the Holding Company, its receipt of the dividends, and its treatment of the matter on its books and records are entirely consistent with the decision that no trust existed.

2. With respect to the 3,500 shares, the evidence shows that they were a part of the 4,000 shares acquired by the Holding Company from Mr. Miller and held in escrow until the delivery of the consideration. The evidence supporting the view that they

were held in trust by the Bank is not compelling and we submit that the District Court erred in holding that a trust was established.

3. As a matter of law there could be no trust in respect to either block of stock. The Holding Company was not authorized to act as trustee, and the Bank was precluded by statute from becoming the owner of the stock. Since the Bank had no capacity to take the legal title, it had no capacity to become the beneficiary of a trust of such property. In this view, the trust which the District Court found to exist was invalid and the Holding Company should therefore report the profit on the sale.

4. If any trust existed, the evidence is perfectly consistent with the view that the Bank's beneficial interest was solely in the proceeds of the sale. We submit that there was at most an agreement to assign the income to be realized from the sale and that upon settled principles an agreement of that kind does not relieve the Holding Company.

I.

ARGUMENT

The 7,500 Shares of Sunshine Stock Belonged to the Holding Company, and Therefore the Profit Realized on the Sale Thereof in 1935 Constituted Taxable Income to It in That Year.

The taxpayer contends substantially that the 7,500 shares of Sunshine stock were purchased and held in trust by the Holding Company, under the agreement set forth in the letter of December 12, 1934, as agent and for the benefit of the Bank which was the sole equitable and beneficial owner thereof; that if the Holding Company had any title thereto at all, it was solely a legal title as trustee for the Bank (Br. 31-39); that since the agreement of December 12, 1934, was equally as binding upon the Government as on the Holding Company for tax purposes, the income realized from the sale of the stock in 1935 was properly taxable to and reported by the Bank in that year as the beneficial owner thereof (Br. 63-68); and that the District Court's findings of fact to the contrary are conclusions which are contrary to the evidence and erroneous, and should therefore be set aside by this Court (Br. 23-30).

We submit that the District Court's findings of fact supporting its conclusion that the Holding Company owned and was properly chargeable with the profit realized on the 7,500 shares, are based on ample substantial evidence, and that therefore the

findings and conclusion should be affirmed by this Court.

Thus, the court below found the following facts: The Holding Company purchased 7,500 shares of Sunshine stock in August, 1934 for $59,576.50, of which 2,500 and 5,000 shares were taken in the names of its secretary as a street name, and the Bank, respectively. (R. 315[4], 447[4], 484[4].) On December 12, 1934, the Holding Company entered into an agreement with the Bank evidenced by a letter of that date, accepted and acknowledged by the Bank, setting forth an understanding that 7,500 shares were to be purchased and held by the Holding Company for the account of the Bank and that the former was to be reimbursed by the Bank for the purchase price of the stock plus a small amount of appreciation to be determined at the end of the year, if necessary, any profit or loss resulting to be that of the Bank. (R. 315-316, 449, 484-485.) On January 6, 1935, an entry was made on the Holding Company's books (ledger and cash receipts journal) showing "appreciation write-up" in respect to the 7,500 shares at the rate of 25 cents a share in the sum of $1,875, in accordance with the above agreement. (R. 448, 486.) The amount of the appreciation was reported by the Holding Company in the 1936 tax return as profit on the sale of the stock.

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[4]The record citations in this paragraph covering pp. 481-496 refer to the District Court's finding of fact; those covering pp. 21-444 refer to the evidence supporting the findings; and those covering pp. 445-465 refer to the court's detailed opinion on the facts and factual conclusions.

(R. 486.) The Holding Company received and retained the dividends paid on the 7,500 shares from August 17, 1934, until the stock was delivered to and sold by the Bank in April, 1935. (R. 447, 486.) The Holding Company reported such dividends as income in its 1935 tax return, in accordance with the oral understanding with the Bank. (R. 486.)

At the Holding Company's annual stockholders' meeting on February 5, 1935, its financial statement as of January 7, 1935, was presented, setting forth in the list of its assets "Other Stock Investments, $61,451.50" which represented its investment (purchase price, $59,576.50, plus appreciation write-up of 25 cents a share, $1,875) in the 7,500 shares, but no reference was made in the minutes that such stock was held by the Holding Company in trust or as trustee for the Bank or that the stock had been sold to the Bank. (R. 305, 451, 486-487.) The minutes of a meeting of the Holding Company's executive committee held on April 12, 1935, showed, among other things, that the Bank "would take over from the Yakima Holding Corporation * * * the 7,500 shares of Sunshine stock already owned by the Yakima Holding Corporation at the cost price of same," in accordance with the understanding contained in the letter of December 12, 1934. (R. 309, 454, 487-488.)

At the time of the purchase of the 7,500 shares in question entries were made on the Holding Company's books (ledger account and cash disbursement journal) entitled "Sunshine Mining Co. stock." (R.

447, 488.) Such entries were designated by the initials "YFNB" for the description of the number and price paid for each share, and similar designations were shown almost without exception on its books for the descriptions of all its other property, title of which was concededly in the Holding Company. (R. 447-448, 488-489.)

In April, 1935, the 7,500 shares of Sunshine stock which had theretofore been delivered by the Holding Company to the Bank were in turn delivered by the Bank to the stock brokerage concern, which sold them on the instruction of the Bank and paid the proceeds of the selling price thereof, $135,835.54, to the Bank and the latter paid such amount plus the Holding Company's costs incurred and the 25% appreciation to the Holding Company, all in accordance with the agreement of December 12, 1934. (R. 485, 490-491.) The profit realized on the sale of the 7,500 shares constituted income to the Holding Company for the year 1935 and not income of the Bank. (R. 489.)

The foregoing negatives the taxpayer's contention that the District Court's finding No. 10 (R. 489) to the effect that the profit on the sale of the 7,500 shares constituted taxable income to the Holding Company for 1935 and not to the Bank (R. 489), is a conclusion and contrary to the overwhelming evidence and therefore should be reversed (Br. 23-30). It is apparent that the findings substantially to the effect that the stock was purchased and owned at all times by the Holding Company until the sale thereof

in 1935 and therefore the profit realized upon the sale constituted taxable income to it in that year, are supported by an abundance of substantial evidence. It is settled that they should therefore not be disturbed upon appeal. *Helvering v. Rankin*, 295 U. S. 123; *Phillips v. Commissioner*, 283 U. S. 589, 605.

Clearly, the facts found support the judgment in respect to taxability of the profit on the sale of the 7,500 shares and where as here the evidence does not compel a contrary conclusion, the appellate court is bound by the findings and conclusion of the trial court. Consequently, they may not properly be set aside (Rule 52(a), Federal Rules of Civil Procedure), as this Court and other courts have frequently held. *Commissioner v. Neaves*, 81 F. 2d 947, 949 (C. C. A. 9th); *Commissioner v. Gerard*, 75 F. 2d 542, 544 (C. C. A. 9th); *Old Mission P. Cement Co. v. Commissioner*, 69 F. 2d 676, 679 (C. C. A. 9th); *Commissioner v. Burdette*, 69 F. 2d 410, 411 (C. C. A. 9th); *Tidwell v. Anderson*, 72 F. 2d 684, 687 (C. C. A 2d); *Prey Bros. Live Stock Commission Co. v. Commissioner*, 36 F. 2d 326, 327 (C. C. A. 10th).

II.

The Remaining 3,500 Shares of Sunshine Stock in Question Likewise in Fact Belonged to the Holding Company, and Therefore the Profit Realized on the Sale Thereof in 1935 Also Constituted Taxable Income Chargeable to It in That Year.

The taxpayer makes substantially the same contentions with respect to the block of 5,000 shares[5] of Sunshine stock as it does in connection with the 7,500 shares of like stock heretofore dealt with under heading I, *supra*, except that it does not challenge the District Court's findings in respect to the 5,000 shares. The argument is that the findings of the court below as to these shares are supported by substantial evidence, and therefore the court correctly held that the profit on the sale of 3,500 Miller shares in 1935 was taxable to the Bank in that year and not to the Holding Company. (Br. 68-71.)

While the court below held that the book entries of the Holding Company contradicted the oral evidence with respect to the ownership of the 7,500 shares and therefore the profit realized upon the sale thereof was taxable to the Holding Company, as heretofore shown, it nevertheless held that this was not true as to the profit on the 3,500 shares here in question. It held further that in the present

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[5]All further references to the block of 5,000 shares of Sunshine Mining Company stock in the Miller transaction should be understood to refer to and include the 3,500-share block here in question which was sold in 1935, the latter having been a part of the former block of shares. (R. 491.)

transaction, separate and distinct from the 7,500-share transaction, the 5,000 shares were acquired from Miller by the Holding Company in a trust capacity for or as agent of the Bank, which was at all times the actual equitable and beneficial owner until the sale thereof in 1935 (R. 492), and that the evidence supported the Trust Company's contentions in so far as the ownership and taxability of the profit on the 3,500 shares were concerned. We think that the evidence does not compel that conclusion and that the District Court erred.

However the pivotal issue is whether the purported trust was valid.

III.

There Was No Valid Trust

The Holding Company's charter and by-laws did not empower it to act as a trustee. (R. 289-298, 459, 476.) The Bank, moreover, was neither legally nor competent to purchase any of the Sunshine Mining Corporation stock for its own account. Revised Statutes, Section 5136 (Appendix, *infra*). That statute reads in part as follows:

> The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities: * * * Except as hereinafter

> provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation.

That statute became effective one year after its enactment on June 16, 1933, and therefore it was in effect at the time the transactions herein took place, allegedly acquiring the Sunshine stock for the benefit of the Bank in 1934. (R. 484-485.) The taxpayer itself admits it would have been improper for the Bank to own and hold the stock in question. (Br. 36.)

The court below erroneously stated that this law contains no positive prohibition against the purchase of corporate stock by a national bank but that such banks' contract to purchase is merely *ultra vires* and voidable, not illegal and void. It concluded, therefore, that the Trust Company's contention—that the Bank could not lose because if the price of the Sunshine stock fluctuated upward or downward, the Bank could enforce the deal or refuse to perform, respectively—must be accepted as correct even though what the parties did herein directly contravened public policy. (R. 471.) Such contention on the part of the Trust Company, however, necessarily recognizes the invalidity of the contract for the reason that, whether or not *ultra vires* or illegal, neither the Bank's credit nor its property could have been subjected to the hazards of any contingent liability resulting from the transactions in question in view of the Trust Company's position that the Bank "could

not lose" but could refuse to perform the contract, if any existed. (R. 471.)

In this situation, it is difficult to conceive of a valid arm's-length tripartite contract existing between the Holding Company, Miller and the Bank, as claimed by the taxpayer, in order to accomplish the desired result—diversion of the profits to the Bank—as the facts indicate. This seems particularly true inasmuch as the Holding Company owned all the stock of and controlled the Bank, and all the moving parties in interest involved in the transactions were identical individuals and officers (including Miller, one of the contracting parties) comprising the board of trustees of both corporations. (R. 483.) Moreover, Miller's performance of the contract *in part* (depositing his 5,000 shares with the Trust Company in escrow), and the Holding Company's definite liability to perform on its part (obligation to deliver its 4,000 shares), as the facts show (R. 312-314), would seem necessarily to invoke the rule prohibiting avoidance of a voidable contract after one of the parties has performed in part and one of them becomes strictly liable to perform on his part. Since the contract herein in respect to the Bank's alleged beneficial purchase and ownership of the Sunshine stock was expressly prohibited by federal statute providing that it could purchase and sell corporate securities "without recourse" for customers only, and therefore afforded no remedy against it in such transactions, the contract was invalid in so far as the Bank was concerned. *Awotin v.*

Atlas Exchange Bank, 295 U. S. 209; cf. also *First Nat. Bank v. Exchange Bank*, 92 U. S. 122; *California Bank v. Kennedy*, 167 U. S. 362, 367, 369; *Concord First National Bank v. Hawkins*, 174 U. S. 364 (all holding substantially that, under similar prohibitory statutes prior to the amendment of Section 5136, Revised Statutes, by the Act of June 16, 1933, while such contracts were not expressly prohibited, nevertheless such prohibition is implied by the failure to grant the power).

Since the facts herein show that the board of trustees of both the Holding Company and the Bank comprised the same individuals, no sound reason appears as to why the transactions in question were handled in the manner in which the Trust Company contends they were handled, unless they admit that the stock was purchased and held by the Holding Company for the benefit of the Bank in order to avoid the inhibitions of Section 5136, Revised Statutes, as amended. Such a position would be tantamount to an admission that circumvention of the banking laws was planned by the board of trustees of the Holding Company and the Bank on one hand, and the vehement denial on the other that the income comprising the proceeds from the sale of the two blocks of Sunshine stock was intentionally diverted and shifted to the Bank in order to avoid taxation.

Accordingly, we disagree with the District Court's above-mentioned views and conclusion that the taxpayer's position in this respect must be accepted as

correct even though against public policy. (R. 471.) Our reason therefor is that under the statute, the Bank had the capacity to take legal title to "investment securities * * * in no case for its own account" and "nothing herein contained shall authorize the purchase by the [banking] association of any shares of stock of any corporation." Therefore, it must necessarily follow that the Bank had no capacity, in turn, to become the beneficiary of a trust of such property (Restatement of the Law of Trusts, Section 117, Appendix, *infra;* cf. *Coleman v. S. R. T. R. Co.*, 49 Cal. 517, 522).

In this view, the trust which the District Court found to exist in favor of the Bank (R. 492) was necessarily invalid. Consequently, there is no support for the decision of the court below that the Bank was the actual equitable and beneficial owner and holder of the 5,000 shares of Sunshine stock. (R. 473-475, 492.) Neither is there any support for the Trust Company's contention to the same effect, therefore, in respect to the 7,500 shares of Sunshine stock (Br. 31-37, 63-68). The many cases relied upon by the Trust Company (Br. 47-49) merely support the view that a trust may be created informally. They do not deal with the question of incompetent parties. Hence they are not in point and have no application to the facts herein.

It follows, we submit, that the Holding Company was chargeable with, and should properly report a taxable income under Section 22 (a) of the Revenue Act of 1934 (Appendix, *infra*), the entire proceeds

realized from the sale of the 3,500 as well as the 7,500 shares of Sunshine stock in 1935.

IV.

Any Interest of the Bank Was Confined to the Proceeds of the Sale of the Stock

The letter of December 12, 1934 (R. 315), which is relied on as creating the trust, dealt with the proceeds of the sale of the 7,500 shares and any claim of the Bank would have been satisfied by diverting the proceeds to it. The letter provides for reimbursement of the Holding Company out of the proceeds of the sale, and it is clear that until that obligation was satisfied the Bank had no control over the stock. The reference to a possible loss being borne by the Bank and its having the benefit of any profit is a clear indication that the Bank's interest was contingent upon the result of the sale. It does not require the conclusion that before the sale the stock was held in trust.

If the Bank's interest was only in the proceeds of the sale, it is evident that the Holding Company was merely agreeing in advance to share with the Bank any profit from the sale. The Holding Company was to have for itself "a small appreciation" over the cost of the stock.

Such an agreement is an assignment of income and "the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised

* * * by which the fruits are attributed to a different tree from that on which they grew." *Lucas v. Earl*, 281 U. S. 111, 115.

In so far as the letter refers to the 4,000 shares acquired from Mr. Miller there is no language indicating a trust. The reference is merely to a sale to the Bank at a stipulated price.

The Holding Company had a purpose of its own to be served by the speculation in the Sunshine stock. The facts plainly indicate that the Holding Company was obliged to raise large amounts of funds to liquidate its liability of $78,000 owing to the First Security and Loan Company. (R. 310.) It was further required to raise additional funds to bolster up the precarious financial condition of its wholly-owned subsidiary, the Bank, as required by the National Banking Department. (R. 446, 483.) It was the plan partially to effect such result by purchasing, with the balance of the funds to be received from the sale of both blocks of Sunshine stock, various notes held by the Bank. (R. 311-312.) Its exchange of 4,000 of its own shares for Miller's 5,000 Sunshine shares was designed primarily to make available to the Holding Company at least $200,000 of "new money" to accomplish the desired purposes. (R. 314.) Another of the several purposes was "to consummate certain plans of reorganization that had been under consideration by the officers of the company" (R. 309) which "would be in keeping with the completion of the plans of reorganization that had been under consideration" in respect to the Bank (R.

311). These plans of reorganization are disclosed by the District Court's finding that "during the time herein involved the Bank had not recovered from the losses sustained during the depression of the preceding years, and by reason thereof the capital of the Bank was impaired, and as a result thereof there was insistence by the National Banking Department that the Bank strengthen its financial position." (R. 483.)

From the foregoing it is apparent that effect was given to all of the Holding Company's purposes through the acquisition and sale of the two lots of Sunshine Mining Stock. This resulted in the Holding Company's realization, upon the sale of both blocks of stock in April, 1935, of proceeds in the sum of $199,225.45 (R. 491), only slightly short of the $200,000 initially desired (R. 314).

The court below found that the Bank suffered impairment of its capital through losses during the depression of preceding years, and that the National Banking Department required that its financial position be strengthened. (R. 483.) This was in effect accomplished by the Holding Company's consummating the plans of reorganization to supply the requisite additional funds for the Bank to the extent of $200,000 (R. 308-312, 314), and that diversion of the proceeds from the sale of the two blocks of Sunshine stock for almost that amount (R. 491) gave substantial effect to the plans. This was accomplished by the Holding Company's delivering, or having delivered in part, 12,500 shares of its Sunshine stock

to the Bank in April, 1935, which sold 11,000 shares thereof through the brokerage concern.

Whatever proceeds from the sale the Holding Company diverted or permitted to be diverted to the subsidiary Bank, therefore, constituted at best a capital contribution or paid-in surplus—but not income—to the Bank, its wholly-owned subsidiary, but no less income to the Holding Company. Article 22 (a) 17, Treasury Regulations 86 (Appendix, *infra*). That regulation provides that such contributions are in the nature of voluntary assessments upon and represent an additional price paid for stock held by the stockholder, but do not constitute income to the recipient corporation. Hence, the amount of the proceeds diverted to the Bank upon the sale of the stock in 1935 constituted merely additional cost of the Holding Company's 4,837½ shares of the Bank's stock held by it as "investments." (R. 305.) Although the regulation refers only to "voluntary pro rata payments by * * * shareholders," contributions other than those in proportion to stockholdings nevertheless come within the rule. G. C. M. 4015, VII-1 Cum. Bull. 120 (1928). Cf. *In re Park's Estate*, 58 F. 2d 965 (C. C. A. 2d), where the court stated (p. 966):

> So where a stockholder sees fit to contribute additional funds to the capital account of the bank when his stock cannot be assessed, he has merely added to the cost of his stock.

Cf. also *First Nat. Bank in Wichita v. Commissioner*, 46 F. 2d 283 (C. C. A. 10th).

Quite clearly, therefore, the transactions effect-

ing the acquisition and sale of the 11,000 shares of Sunshine stock at large profits, which were diverted to the Bank, amounted to no more than a capital contribution by the Holding Company, its sole stockholder. This harmonizes with the plans outlined in the minutes of its executive committee's meeting held April 12, 1935 (R. 308-312), and as shown in Miller's letter of December 11, 1934, to the Trust Company (R. 314), and the capital contribution was in fact credited to the Bank's surplus account (R. 320, 456, 468), in accordance with the provisions of Article 22 (a)-17 of Regulations 86.

We have already shown that, under the agreement, the 7,500 shares of Sunshine stock were purchased by the Holding Company and delivered to the Bank for sale through the brokerage concern, but that the Holding Company at all times had control of and received the dividends or earnings paid on the stock and so reported them in its 1935 tax return; also that Miller, from whom the Holding Company acquired the 5,000 shares allegedly for the benefit of the Bank, likewise received the dividends on those shares which he had deposited in escrow with the Trust Company. These facts are incompatible with the actual ownership of the 11,000 shares in anyone other than the Holding Company; just as much so as is the taxpayer's incongruous contention that the Holding Company bought and held the stock for the account and benefit of the Bank, even though the latter was not legally competent to buy, own and/or sell the stock for its own

account and the Holding Company continued to receive and report, as income, the dividends paid thereon, as heretofore shown.

It is apparent from the facts herein that the 11,000 shares of stock were at all times under the control and subject to the unfettered command of the Holding Company since acquisition. Its diversion of the proceeds from the sale of the stock to the Bank did not change the result. It is settled that "the income that is subject to a man's unfettered command and that he is free to enjoy at his own option may be taxed to him as his income, whether he sees fit to enjoy it or not." *Corliss v. Bowers*, 281 U. S. 376, 378. Moreover, the power to dispose of income is the equivalent of ownership of it, and the exercise of such power to procure the payment of income to another is the enjoyment and therefore the realization of the income by him who exercises it. *Helvering v. Horst*, 311 U. S. 112; cf. *Lucas v. Earl, supra.*

In view of the foregoing, we submit that the entire profit realized from the sale in 1935 of the 11,000 shares of Sunshine mining stock in question was, under the provisions of Section 22 (a) of the Revenue Act of 1934, properly chargeable and taxable income to the Yakima Holding Corporation in that year.

CONCLUSION

The District Court's judgment in respect to the taxability of the proceeds realized from the sale of the 7,500 shares of Sunshine Mining Company stock is correct and in accordance with law and the authorities. The judgment to that extent should therefore be affirmed.

The District Court's judgment in respect to the taxability of the proceeds realized on the sale of the 3,500 shares of Sunshine Mining Company stock is erroneous and not in accordance with law and controlling authority. The judgment to that extent should therefore be reversed and judgment entered in favor of the United States forthwith.

Respectfully submitted,

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APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

Revised Statutes:

SEC. 5136 [as amended by Act of June 16, 1933, c. 89, 48 Stat. 162]. Upon duly making and filing articles of association and an organization certificate, the association shall become, as from the date of the execution of its organization certificate, a body corporate, and as such, and in the name designated in the organization certificate, it shall have power—

* * * *

Seventh. * * * The business of dealing in investment securities by the association shall be limited to purchasing and selling such securities without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities: * * * As used in this section the term 'investment securities' shall mean marketable obligations evidencing indebtedness of any person, copartnership, associa-

tion, or corporation in the form or bonds, notes and/or debentures commonly known as investment securities under such further definition of the term 'investment securities' as may by regulation be prescribed by the Comptroller of the Currency. Except as hereinafter provided or otherwise permitted by law, nothing herein contained shall authorize the purchase by the association of any shares of stock of any corporation

* * * *

(U. S. C. 1940 ed., Title 12, Sec. 24.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22(a)-17. *Contributions to corporation by shareholders.*—If a corporation requires additional funds for conducting its business and obtains such needed money through voluntary pro rata payments by its shareholders, the amounts so received being credited to its surplus account or to a special capital account, such amounts will not be considered income, although there is no increase in the outstanding shares of stock of the corporation. The payments under such circumstances are in the nature of voluntary assessments upon, and represent an additional price paid for, the shares of stock held by the individual shareholders, and will be treated as an addition to and as a part of the operating capital of the company. (See articles 22 (a)-14 and 24-2).

Restatement of the Law of Trusts:

SEC. 117. LACK OF CAPACITY TO BE BENEFICIARY.

Except as stated in Sections 118 *and* 119 [re capacity of married women for their separate use, and unincorporated associations, to be bene-

ficiaries of a trust, respectively] *a person who has no capacity to take the legal title to property has no capacity to become the beneficiary of a trust of such property, and a person has capacity to continue to be beneficiary of a trust of property only to the extent that he has capacity to hold the legal title to such property.*

Comment:

a. Corporations. If a corporation cannot take title to land or to land of more than a certain value or except for certain purposes, it cannot become the beneficiary of a trust of land or of land of more than the designated value or for other than the designated purposes. If a corporation can take but cannot hold the title to land against the objection of the State, it cannot continue to hold the beneficial interest against the objection of the State.

* * * *